

A conditional sale to an organization holding an active exemption identification "E" number is not subject to the Retailers' Occupation Tax and Use Tax obligations upon exercising the nominal buyout option. See 86 Ill. Adm. Code 130.420 and 86 Ill. Adm. Code 130.2007. (This is a GIL.)

September 21, 2004

Dear Xxxxx:

This letter is in response to your letter dated April 26, 2004, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

I am requesting a written letter of determination regarding the following situation and its taxability. We are an equipment leasing company and are entering into a lease with ABC. ABC has supplied us with a letter from the State of Illinois Department of Revenue stating, "this organization is exempt from the Retailer's Occupation Tax (both state and local), The Use Tax, and the Service Use Tax." This lease has a \$1.00 buyout purchase option and will be considered a conditional sale based on the State of Illinois' definition of leasing situations. According to a General Information Letter we received from the Illinois Department of Revenue in 1997, this type of conditional sale would be taxable on all receipts received. Since this lessee is exempt from these taxes, will XYZ be liable for these taxes or will we not collect or pay the Retailer's Occupation Tax either?

On a true lease the lessor is considered the end user and the use tax is charged on the price of the equipment and not "passed through" to the lessee. If the above-mentioned lease had been a true lease would XYZ have to pay tax even though the lessee is exempt from tax?

If you have any further questions, please don't hesitate to contact me.

DEPARTMENT'S RESPONSE

For general information purposes please refer to 86 Ill. Adm. Code 130.2010, the Department's regulation that covers the taxation of leases. Under Illinois law, "true leases" and "leases" that are actually conditional sales contracts are treated differently for Retailers' Occupation Tax and Use Tax purposes. Please note that the State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases. A conditional sale is usually characterized by a nominal or one dollar purchase at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

Under Section 130.2010(a), persons who purport to "lease" the use of property, but in fact sell such tangible personal property to nominal "lessees," are considered to be making conditional sales subject to Retailers' Occupation Tax. Such would be the case when the agreements contain nominal purchase options at the end of the lease term. In these situations Retailers' Occupation Tax is due on all the payments received by the "lessors." Interest or finance charges may be excluded from gross receipts under installment contracts if the books of the retailers ("lessors") clearly reflect the amounts of the payments attributable to financing. See 86 Ill. Adm. Code 130.420.

If a "penalty" is added to the base retail price in the event that the purchaser does not pay such price within a specified time and such penalty is paid to the seller, such "penalty" becomes a part of the taxable receipts from the sale. See Ill. Adm. Code 130.420.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax Obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See subsection (a)(3) of 86 Ill. Adm. Code 150.310.

Under Illinois law, lessors may not "pass through" their tax obligation to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq. There are also some limited exceptions to the general rule described in the preceding paragraphs. There is an exemption from Retailers' Occupation Tax for sales of tangible personal property to lessors who lease that property to governmental bodies under a lease of one year or longer. See 86 Ill. Adm. Code 130.2012. In addition, the sale of computers and communications equipment and equipment used in the diagnosis,

analysis, or treatment of hospital patients is exempt when sold to lessors who lease that property under leases of one year or longer with hospitals to whom the Department has issued a tax exemption identification number. See 86 Ill. Adm. Code 130.2011.

In general, the Illinois Retailers Occupation Tax and Service Occupation Tax are imposed upon the total gross receipts received by retailers who make sales of tangible personal property to Illinois end users.

All persons purchasing merchandise at retail from a retailer in the State of Illinois are subject to applicable State and local sales taxes unless certain exemptions apply to a particular sale or to an exempt organization. Organizations make application to the Department and are determined to be exclusively religious, educational, or charitable, receive an exemption identification "E" number. See 86 Ill. Adm. Code 130.2007. This number evidences that this State recognizes that the organization qualifies as exempt from incurring Use Tax when purchasing tangible personal property in furtherance of its organizational purpose. An organization must provide a retailer with its "E" number to document the exemption.

If an organization or governmental body does not have an "E" number, then its purchases from a company are subject to tax. Only sales to the organization or governmental body holding the "E" number are exempt, not sales to individual members of the organization. The Retailers' Occupation Tax does not apply to receipts from sales to organizations holding a valid "E" number.

Conditional sales made to an organization possessing an "E" number issued by the Department are not subject to Retailers' Occupation Tax and Use Tax. Lessors, however, incur Use Tax on property leased under a true lease to an organization possessing an "E" number, with the limited exception set out in Sections 130.2011 and 130.2012.

I hope this information is helpful. If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Edwin E. Boggess
Associate Counsel

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